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Small Business has Big problems

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- taxes
- working capital
- overhead
- hidden costs

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SMALL BUSINESS HAS BIG PROBLEMS

Running a successful business these days is a lot more complicated than it used to be. That goes for the small and medium-sized business as well as for the big concern.

Costs are high. And as competition returns to normal, the job of maintaining the profit margin between costs and income will require a lot of business brains. At times it will take special handling and special skills.

The paper work alone, much of it financial paper work, is often so enormous that one is reminded of the aircraft manufacturer who ruefully said he could always tell when a plane was finished— at the moment the plane and its paper work both weighed the same.

When special skills are needed, the smaller-sized businessman is turning increasingly to the accounting profession for practical help. The accounting profession, in step with the times, is providing more and more help in solving problems the average businessman faces.

Let's take some examples . . . . .

The Search for Hidden Costs

Businessman Robinson said that he really ought to be doing all right. His kind of retailing wasn't very complicated. He knew what things cost, and he knew what it took to handle them: then he just had to make a reasonable markup, and he had a selling price. Still, somehow, there didn't seem to be as much margin as there ought to be . . .

Robinson's certified public accountant, in the course of an audit which included a special analysis of the company's affairs, began to uncover some reasons for the trouble: hidden costs.

It was not Robinson's habit to buy stock out of town, for example, but he had been doing so quite frequently to fill special orders. That meant "now and then" freight bills which had been disappearing into overhead instead of being allocated to the cost of goods sold. The profit margin wasn't really what it seemed to be.

And another thing—Robinson maintained a crew of servicemen, whose area had been expanded to get business. Naturally it cost more to send the men farther away from home base; but these costs, too, were being absorbed—and not by the customers. In short, the special orders and the extra service trips looked profitable when sold or billed at the usual rates, with the usual margin. A careful analysis of the figures showed that they were not profitable—they were losing money.

The CPA helped Robinson set up his books so that he could make a proper charge for the special services to his customers. These charges didn't add much to any single order from any customer, but taken all together, they made a lot of difference to Robinson.

The Inventory that Grew and Grew

Now take a more complicated case —George Brown and his inventory.

A small wholesaler, Brown had been expanding gradually for ten years or so, but had never bothered to take a physical inventory — it didn't really seem necessary. Every year he estimated his opening and closing inventories at an even $5,000.

But Brown overlooked one fact. His inventory was growing as his business grew and so, when he carelessly kept his estimate at $5,000 in his tax return, he was mistakenly including amounts which went into building up stocks under "cost of goods sold."

Finally he did take inventory and discovered — to his amazement — that goods on hand came to something like $52,000. His bookkeeper told him that he faced the prospect of an $18,000 tax bill! Reason: if he reported opening inventory at $5,000 and closing inventory at $52,000, for one year, the $47,000 difference—presumably—represented income that year.

In something of a panic, Brown sought the advice of a CPA. The CPA satisfied himself—and the Bureau of Internal Revenue—that no fraud had been involved, and arranged to file amended tax returns for previous years, showing a more gradual growth of inventory and recomputing the actual cost of goods sold each year.

On this basis, with one year of offsetting losses, the total additional tax liability was cut down very substantially.

This particular story ended more or less happily, but if Brown had not discovered the discrepancy and reported it himself before the Internal Revenue agents did, and if he had not had the advice of a tax expert, he might have found it difficult to prove that he had not intended to defraud the government, and a penalty might have been assessed in addition to the tax. He decided that a regular audit by a CPA would be a very good idea.

The Capital on the Shelf

"The main trouble," said businessman Jones, "is that I haven't got enough working capital to move around with. I buy and sell just about the way I always have, and I've allowed for the increased cost of merchandise, but I'm short of ready money. I can't seem to figure out where the trouble is. Can you find out?"

The "you" in this case was a CPA who went to work to get the facts.

Jones had a medium-sized store with half a dozen clerks. Before the war, most of his clerks had been with the business for a number of years, and they all had a good idea how the items in their departments were selling and when new stocks should be ordered. Jones had never felt the need of a system to keep track of his sales and purchases by lines. For that matter, he had always had a pretty good idea about it himself.

But during the war, and since, he had had a complete turnover of clerks and most of them didn't stay long enough to get a real feeling for the business. At the same time, the business itself was changing; customers were not buying the same things they used to. Jones still had the "feeling" of the business and was still making a profit, but not what it should have been on his volume of sales. His inventory had got badly out of balance.

The time had come for him to put his business on the basis of system, in place of experience and guesswork. He hated to do it, because he thought he would lose more in paper work than he would gain in efficiency.

But the CPA helped him to put in a system which actually gave him the information he needed without taking much more time than the cumbersome sales slips he had always used.

Even before there was time to analyze the business on the basis of the new records, a careful study of Jones' orders to his suppliers over the previous year, compared with a physical inventory of stocks on hand, made possible a prompt start toward bringing inventory into balance with the current pattern of sales.

In this case, Jones was able to adjust his rate and type of purchases, and translate "too much inventory" and out-of-balance inventory into adequate working capital, in time to avoid real trouble. There isn't always time.

Wagons and Cost

Tom Brady was president of a small manufacturing company which made furniture — and farm wagons. The original business had been farm wagons entirely, when it was started by Brady's grandfather many years before. There was still some demand for the wagons, and since they had always been a profitable item, the firm kept right on making them.

But in this case, too—for different reasons—profits were not what they should have been.

When his certified public accountant came in to make an annual audit, Brady complained that he didn't seem to be making as much money as he thought he should.

"It's going to be a bit difficult to trace your trouble from your books," the CPA said. "You don't keep your cost records separate for your different lines, and you probably have a loss somewhere that you don't know about.

For example, how do you figure out what to charge for a farm wagon?"

"Well," Brady answered, "it's really a matter of history. We've always made a profit on the wagons, so when lumber goes up, or when wages go up, I add a reasonable amount to the price to cover the higher cost, and figure that should be about right."

But it wasn't as simple as that. When the main business of the firm had been making farm wagons, the prices were right to show a fair profit. But when the volume dropped off, the actual cost of making wagons went up considerably more than the increases in lumber and wages.

The thing Brady hadn't figured was a proper allocation of his overhead. Making only a few wagons on special order meant disrupting his regular schedules on furniture and took a lot more time and plant space per wagon than it had when they were in larger volume production. The wagons were also using up expensive materials which did not average out the same as the over-all increase in lumber costs for the whole factory.

So Brady was not making any money at all on wagons—he was losing money on every one he made.

But, as he said himself, he might have gone on doing it for years if he had not had the advice of a specialist in the analysis of costs.

Farm wagons, of course, are a specialty. Not many people make them these days. But a lot of small manufacturers do face similar problems when they make several different products, using the same basic raw materials, but selling in different markets to meet different demands. Under such circumstances, finding out the actual cost of each item—and so what it's selling price should be—requires special record systems which take a lot of technical skill to install.

The Need for Specialists

The four examples which have been given—all of them, incidentally, based on actual cases—are typical of problems which certified public accountants can help the small businessman to solve.

Hidden costs, special tax liabilities, unbalanced inventories, losses in one line eating up profits from another—all of these can create problems in any business, and the solution is not always apparent to the naked eye.

Every small businessman must be a specialist in several fields: he must know where to buy goods and materials, how to make or merchandise his products, what prices he can charge in the markets which are open to him, and when he must change his lines to suit his customers. In most cases, he doesn't have time to keep up to date on taxes, cost accounting, and efficient record keeping.

It is surprising, for example, how many businessmen pay more taxes than they really owe. And of course there are many others who fail to set aside funds to cover tax liabilities because they just don't know about them.

When it comes to these increasing complexities of paper work, more and more small businessmen are finding that it saves them time and money to turn to a specialist in that field—the certified public accountant.

A Growing Profession to Meet the Need

As a result of the needs of business for special accounting skills, accountancy has become the fastest growing profession in the United States. In the years between the two World Wars, from 1920 to 1940, the number of certified public accountants in the country increased by 347%. Since 1940, the number of CPAs has again almost doubled, and there are today far more students of accounting in colleges and universities than ever before.

At the same time, the profession has held firmly to its traditional standards of competence and independence. The certified public accountant must have demonstrated his ability by passing a written examination, conducted by the state, comparable to those for doctors, lawyers, architects, and other professional men whose work affects the public interest. Through their state and national organizations, CPAs also subscribe to a code of professional ethics.

The certified public accountant, therefore, brings to his work a demonstrated skill and independence of judgment which the businessman can count on when he needs advice and assistance.

The certified public accountant approaches his work with a feeling of responsibility, as well as of opportunity. If health conditions in this country suddenly took a turn for the worse, we would naturally look to the medical profession to step in individually and collectively. The growing problems of small and medium-sized business have created an equal need for professional treatment, and the accounting profession has accepted this challenge with full realization that business health is just as important as individual health to the ultimate welfare of the community.